January 3, 2006

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: New England Gas Company Request for Changes to its Gas Commodity Purchasing Practices in its Fall River and North Attleboro Service Areas

Dear Secretary Cottrell:

By this letter, New England Gas Company ("New England" or the "Company"), is requesting the approval of the Department of Telecommunications and Energy (the "Department") for certain changes to the Company's gas commodity purchasing practices for the Fall River and North Attleboro service areas. If implemented by the Company, these changes would work to mitigate the increasing volatility of natural gas prices and stabilize the price that customers would pay for natural gas through the Gas Adjustment Factor ("GAF") of the Company's Seasonal Cost of Gas Adjustment Clause tariff.

Over the last few years, gas customers across New England have experienced substantial fluctuations (and increases) in rates, frequently at the height of the winter heating season. Recent experience and industry literature indicate that the volatility of the wholesale natural gas market will not be relieved anytime soon and some industry observers feel that at least some of the price movements are the result of market speculation over the short-term rather than market fundamentals over the long-term. The Company's proposed purchasing plan would achieve the goal of stabilizing gas costs for customers through the implementation of a program that involves systematic purchasing of a portion of the winter gas supply over a 24-month period through a forward purchasing strategy.

Currently, the Company purchases approximately 28 percent of the total gas volumes needed to meet peak-season customer requirements in roughly equal increments over a 7-month period. These volumes are stored upstream of the Company's city gate and in peaking facilities owned and operated by the Company. Much of the remainder of the gas supply procured to meet customer requirements is purchased on a "first-of-the-month" or "spot" basis throughout the peak season, typically based on a published index price. These prices are subject to market volatility and short-term speculation, and therefore, have the potential to drive price changes in the GAF.

In addition, a phenomenon that has developed in recent years is that natural gas prices have shown a tendency to increase sharply in response to any market influence, such as severe cold weather, hurricanes or increases in oil prices. However, when favorable events occur, the market price has not corrected itself downward to nearly the same degree as the increase. For example, during severe winter cold snaps experienced in the last few winters, New England spot prices increased to as much as $70 per dekatherm and often traded at double or triple the level experienced during periods of normal weather. Conversely, during warmer weather this past winter, prices only dropped to levels slightly below the prior 12-month average. Despite record levels of drilling to stem the price increases and offset continued market demand, it appears that this pattern of asymmetric price increases and severe spikes as a result of the tightness in the market will continue for some time.

Therefore, to reduce the impact of these market conditions on customers, the Company proposes to modify its purchasing practices by purchasing up to 50 percent of its (non-storage) annual gas-supply purchase requirements in advance. To accomplish this objective, the Company would begin locking in purchases of supply starting two years prior to the month of delivery and ending four months prior to the month of delivery. This forward purchasing strategy will distribute monthly gas purchases over a 20-month period preceding the start of each month. The Company has deployed a similar structure for its Rhode Island service territory and has been successful in stabilizing rates for customers. Attached is a graph showing the gas cost portion of rates for Rhode Island, Fall River and North Attleboro. Below is an illustrative example:

July 2007	
Projected Purchases for July 2007 Delivery:	200,000
Projected Purchases for July 2007 Storage Injection:	100,000
Total:	300,000
50% of Total Purchases:	150,000
Monthly Purchase Level- July 2005 to February 2007: (20 Months)	7,500

Distributing purchases over the period beginning two years before the month of delivery and ending four months prior will help to stabilize prices for customers because the prices of half of all forecasted gas purchases (plus all gas in storage), will be locked in prior to the start of each month. As a result, much less of the supply will be subject to first-of-the-month and spot market price changes during periods of pricing volatility.

In most cases, the basis portion of the price paid by the Company for gas commodity is based on the final closing price of the appropriate published index where the gas is purchased, less the actual NYMEX closing price for the month. The Company would implement the purchasing plan by locking in the NYMEX portion of gas commodity prices with suppliers that already serve the Company. Thus, the basis paid will be the same basis that New England Gas would have paid had it purchased the gas for base-load delivery, as it does today.

The Company is proposing to use this mitigation strategy for both the peak and off-peak periods because recent experience has shown that both winter and summer months are now subject to substantial price volatility. During the summer months, natural gas is used to fuel gas-fired electric generation facilities supplying electricity for cooling and air conditioning purposes throughout the U.S. Thus, the supply/demand dynamic has shifted in relation to summer months, which historically experienced prices lower than peak winter months. In addition, pricing for the winter heating season will be more stable where storage-injection prices over the summer months are less subject to market volatility. By locking in prices for both the peak and off-peak seasons, the percentage of purchased gas costs stabilized for the benefit of customers rises from 50 percent of total deliveries to approximately 65 percent of total deliveries in a normal winter.

The stabilization of GAF prices will also provide a benefit to transportation customers. Many transportation customers purchase their supply for periods of a year or more, particularly smaller transportation customers. Frequent rate changes caused by the exceptional volatility of gas prices are confusing to customers and make it very difficult for customers to make educated buying decisions. A reduction in the frequency and magnitude of rate changes is likely to prove beneficial to customers evaluating transportation service as an alternative to sales service by providing them with a more stable price to use in comparison shopping. It also provides a more accurate and consistent price signal for investments in conservation because the prices are indicative of long term trends rather than short-term volatility.

In terms of the timing of implementation, New England Gas would propose to begin purchasing gas under the plan immediately following Department approval, with the pricing result of the program fully apparent 24 months following the approval. The Company also proposes to implement an expanded proportion of locked-in purchases for earlier months in order to achieve the benefits of the plan on an expedited basis. That is, the Company proposes to purchase at a rate higher than the $1/20^{th}$ level so that the level of supply locked in starting in July 2006 would reach the 50 percent level. Such purchases would be made uniformly, but spread over the lesser number of months available for purchase. In the event that prices weaken significantly from current levels, the Company also proposes that it accelerate the make up of some of the shortfall in locked purchases to achieve the benefits of this program sooner. It would purchase an agreed upon portion of its supply at one time rather the risk that some event, such as an increase in demand due to exceptional weather or hurricane damage to Gulf production, causes prices to rise.

As noted above, the Company has had this same approach in place in Rhode Island for several years and, over that time, customers have experienced price increases as a result of price volatility in the wholesale gas markets, but to a far lesser degree than customers in Massachusetts. For example, for the forthcoming peak season, the Company has requested a 22 percent increase in its Rhode Island Gas Cost Recovery factor, as compared to the approximately 33 percent increase currently in effect in the Company's Fall River service area. In total, the Company estimates that Rhode Island customers have avoided $86.6 million in gas costs over the past three years as a result of the Rhode Island purchasing plan, which has allowed the Company to lock-in prices prior to the heating season. These results are documented in the information request responses that have been submitted to the Rhode Island Public Utilities Commission in the Company's annual Gas Cost Recovery filing, Docket No. 3696. A comparison of residential heating GAF rates for customers of the North Attleboro, Fall River and Rhode Island service areas is attached hereto as Appendix 1.

The Company would implement the lock-in of forward prices by actually purchasing physical supply that would be taken as uniform daily quantities during the month of delivery. This approach closely parallels the purchase of monthly base load supply at monthly published index pricing. Suppliers for Rhode Island have been amenable to such purchasing, which is executed simply by locking the NYMEX portion of the price while in most circumstances relying on the final published index for the month of delivery to determine the basis portion of the price. Each forward purchase is generally for one month and is contractually arranged using a simple term sheet that establishes the quantity, price, and delivery point for that purchase. Therefore, even though the arrangement may be for a delivery two years hence, the contract covers the purchase of supply only for a single month. Other contract terms are established by reference to a blanket contract based on the form established originally by the Gas Industry Standards Board ("GISB"), now the North American Energy Standards Board ("NAESB"). Note that the NAESB is not a contract in and of itself, in that it specifies no commitment by either party, the supplier or the Company, to sell or purchase supply. The NAESB standard only specifies the terms and conditions under which a purchase or sale will be executed in the event that a quantity, location, and price (a deal) may be agreed upon. The Company has many NAESB contracts in place, some of which have never been utilized to make an actual purchase.

Please do not hesitate to contact me at (401) 574-2223 if further information would assist in the Department's consideration of this proposal.

Sincerely,

Gary L. Beland
Director, Gas Supply

Attachments

cc: George Yiankos, Director, Gas Division (3 copies)
Kevin Brannelly, Director, Rates & Revenues Division
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